[redacted]

June 2, 2011

The Honorable Dave Camp
Chairman
Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Camp and Ranking Member Levin:

On behalf of the Retail Industry Leaders Association (RILA), I write to offer retailers' perspectives on tax reform for your committee's hearing today titled "How Business Tax Reform Can Encourage Job Creation." RILA supports tax policies that will improve the business climate for retailers, both domestically and internationally, by helping them continue creating jobs, investing in this country, and bring price-competitive value to American consumers.

By way of background, RILA is the trade association of the world's largest and most innovative retail companies. RILA promotes consumer choice and economic freedom through public policy and industry operational excellence. Its members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than $1.5 trillion in annual sales, millions of American jobs and more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

Growth-Orient Tax Reform: Lower Business Tax Rate

The retail industry is vital to our nation's economy, representing one of the largest industry sectors in the United States with nearly 15 million jobs and $3.9 trillion in annual sales overall in 2010. The industry pays billions of dollars in federal, state, and local income taxes, and collects and remits billions more in state and local sales taxes. At the federal level, retail taxpayers typically have among the highest effective tax rates, hitting the top statutory rate of 35 percent in many cases. As you consider tax-reform options, one of the most far-reaching options that the Committee could endorse would be a reduction in the federal tax rates on business income.

The last major overhaul of the system occurred with the enactment of the Internal Revenue Code of 1986, which substantially reduced the corporate tax rate along with major restructurings to the corporate and individual tax system. Over the ensuing 25 years, Congress has made thousands of changes to the tax code increasing its complexity and tax rates, resulting in greater burdens for American businesses. Today, the United States has nearly the highest statutory tax rate on corporate income, which has a number of significant ramifications for U.S. retailers.

Overall, high corporate taxes reduce the availability of critically needed capital for business to invest in their workforce. A number of studies confirm that a significant share of corporate taxes is borne by labor. Thus, a reduction in the tax burden will free companies to create new jobs, increase real wages and income, and improve standards of living for U.S. workers. With the unemployment rate hovering around 9 percent nationally, this is a critical opportunity for Congress and the Administration to reverse the job losses that have occurred over the past several years.

Moreover, our current high corporate tax rate hinders retailers' ability to maintain their existing operation and invest for the future. Especially in the current economic environment where the flow of private-sector capital has been constrained, a lower tax rate would free up essential corporate earnings for investments in new equipment, facilities and products. Similarly, it would enable retailers to retain more of their earnings to reinvest for the long-term growth of their companies, which will contribute to nation's economic recovery and ultimately to sustained economic expansion.

Looking beyond the domestic benefits, a lower corporate tax rate also holds significant potential for improving the competitiveness of U.S. businesses. In recent years, a growing number of U.S. retailers have expanded into the global marketplace. Yet, the United States is set to have the highest corporate tax rate in the world once Japan implements its proposed rate reduction, and the United States remains one of the only countries with a system for taxing worldwide income. As a result, the United States has created a difficult environment for its multinational businesses to compete in the global economy. And further exacerbating this situation, other members of the Organisation of Economic Cooperation and Development (OECD) have been pursuing measures to reduce their tax rates. Lowering the U.S. corporate tax rate would help level the playing field for U.S. multinationals and encourage companies to keep jobs and investments in this country. At the same time, it is important to recognize the tremendous growth in the number of businesses operating as pass-through entities (e.g., sole proprietorships, partnerships, limited liability companies, and S corporations), including some RILA members. These business taxpayers are critically important to the U.S. economy and must be taken into consideration in the debate if overall tax reform is to be successful.

For the foregoing reasons, RILA applauds the Chairman's call for a significant reduction in the rate applicable to U.S. corporations and other forms of business. We encourage the Committee to endorse this approach as a step toward improving the business climate for retailers, both domestically and internationally, which will help the retail industry continue creating jobs, investing in new equipment and technologies, and contributing to the nation's long-term economic growth.

Principles for a Simpler, Permanent and Stable Tax System

While we believe a reduction in the business tax rates is fundamental to successful reform of the tax code, we also recognize that myriad other aspects of the tax law must be examined in the overall effort to broaden the tax base and simplify the tax code. To contribute to that goal, RILA has developed the attached a set of tax reform principles. These principles represent a foundation on which a tax system can be built that will achieve necessary revenues while minimizing the burdens and complexities of our current tax system, which stifle innovation, hinder job creation, and deter overall economic growth.

Fundamental to any successful tax reform is a simple, permanent, and stable tax system. While RILA strongly endorses the objectives underlying tax reform, we urge the Committee to be cognizant of this imperative. Every day, businesses across the country struggle with the increasingly complex tax code. Current law requires a substantial number of employees, advisors, and time for the required tax compliance, including tax accounting and reporting. Moreover, the current system also forces retailer to expend enormous resources to undertake annual audits by the Internal Revenue Service (IRS), which often entail a lengthy and costly process for resolving frequent disputes over the application of the tax laws and regulations.

Clearly, a simplified tax system would mean significant savings for taxpayers and the IRS by lowering compliance costs, reducing filing burdens, and minimizing disputes between taxpayers and the government, freeing resources to be put to more productive use.

Similarly, business taxpayers would benefit greatly from a tax law that is stable and predictable. Over the past two decades, dozens of provisions have been added to the tax code, many well intended and achieving their particular employment, investment, or other objective. Yet, in too many cases, these provisions were added on a temporary basis, even when the tax policy objective should have been permanent. Examples particularly relevant to the retail industry include 15-year depreciation for improvements to retail and restaurant property, the research and development tax credit, the Work Opportunity Tax Credit (WOTC), and the controlled foreign corporation look-through rules, to name a few. And, compounding the tenuousness of these provisions are recent instances when they have expired and taxpayers have been left with no certainty of even retroactive renewal until nearly the end of the year in which the tax provisions were supposed be effective.

Long-term planning is essential for business success, and with federal and state taxes playing such a significant role in retailers' financial decision making, the continual expiration and uncertainty of renewal of so much of the tax code has had adverse consequences – it has forced increased tax reserves, postponed investments in new facilities and improvements, and held back critically needed new jobs.

Accordingly, RILA urges the Committee to resist including temporary provisions in tax reform legislation. While we appreciate that significant changes to the current tax system will necessitate the need for transition rules, which are inherently temporary, we encourage the Committee to establish such rules that provide adequate time for implementation of a new tax system and that take into account existing agreements, practices, and other requirements without letting them become new expiring provisions that become another source of uncertainty.

This country is in desperate need for an efficient and effective tax system. Once that is achieved, the temptation to make on going changes must be resisted.

Additional Retail Considerations for Tax Reform

For RILA members, the need for lower tax rates and a simple, stable and predictable tax code are top priorities for tax reform. As the Committee examines all the contours of tax reform, we also offer some considerations on select issues that have been of historic importance to the retail industry.

Inventory Accounting Methods

In the context of broadening the base, inventory accounting methods are often referenced as tax expenditures or benefits that could be eliminated. RILA strongly believes that such a view is erroneous and misguided. Any effective tax system must have rules to determine which goods are sold in a given year and which remain in a business' inventory for future sale. Similarly, procedures are necessary to determine the cost of the merchandise sold and the value of the products that remain in ending inventory for a business to clearly reflect its income that is subject to tax.

Without such rules, businesses would be forced to employ a system of specific identification, with each product sold having to be traced back to its original purchase price. In the retail environment such a system would be simply infeasible. A retailer may have hundreds of thousands of products for sale on a given day in hundreds of stores across the country. Moreover, a retailer will continually purchase quantities of a single product (e.g., style and size of a shirt, type of hammer, particular quantity of a brand of aspirin, etc.) in order to maintain a sufficient supply for sale. Since each product is indistinguishable from the other, it would impossible to assign the actual cost to the product at the time it is ultimately sold.

Given that inventory accounting methods are indispensable, RILA submits that they should be treated as fundamental operating rules, not a tax expenditure or other benefit that could be eliminated to offset other tax reforms, such as a reduction in tax rates.

The existing inventory accounting methods, on which retailers have relied for decades, enable retailers to assign costs to the goods sold and reflect their income clearly. For the retail industry, these inventory accounting methods include the first-in/first-out (FIFO) method, the last-in/first-out method (LIFO), and the retail inventory method. For purposes of determining a company's remaining inventory at year end, financial and tax accounting rules also permit businesses in certain cases to write down the book value of an inventory item – under the lower-of-cost-or-market (LCM) method – to take into account a decrease in the economic value of the item offered for sale.

We are concerned by the Administration's proposals in its budget submissions to repeal LIFO and LCM (particularly under the retail inventory method), both of which are widely used within the retail industry. For many retail businesses, LIFO is a much more accurate method for measuring financial performance and calculating the associated income tax. LIFO takes into account the greater costs of replacing inventory as costs rise, thereby giving a more conservative measure of both the financial condition of the business and the economic income subject to tax. Absent LIFO, phantom profits would be taxed, which would be inconsistent with the fundamental principle of U.S. tax law that unrealized appreciation in the value of assets is ordinarily not taxed.

LIFO repeal would have two adverse effects on countless retail businesses. First, they would have to recapture their LIFO reserves, which would result in substantial additional cash required to pay the resulting income tax, even if spread over several years, especially for businesses that have relied on LIFO for many years or even decades. This would amount to an enormous retroactive tax increase by repealing fully authorized deductions from income with respect to products sold, in many cases years or decades in the past. Moreover, since companies would have no economic income from such an accounting adjustment, they would effectively be taxed on non-existent cash flow. Second, LIFO repeal would create future tax increases for businesses if inflation accelerates as some expect due to the fiscal imbalances facing the United States. Since inflation increases prices, a business that can no longer utilize LIFO would have to calculate its taxable income based on older inventory costs that do not reflect the inflationary growth in prices, resulting in a higher future tax bills with less earnings available for growth, capital investment, and job creation.

Similarly, the LCM method allows retailers to write down the book value of their ending inventory that has declined in economic value, which frequently occurs with products like clothing at the end of a season or when particular styles change. The loss in value is a real economic loss, and these methods allow businesses to recognize the loss in the year it occurs rather than having to wait until it is able to dispose of the inventory. Moreover, any recovery in the value of the inventory in a subsequent year is not lost since the business would then recognize a larger amount of taxable income in the year the inventory is sold.

Repeal of the LCM method would mean higher taxes on a retailer that would no longer be able to account for a current economic loss in inventory value when it occurs. In addition, during economic downturns, the value of the LCM write-down will also grow, especially under the retail inventory method as retailers are forced to mark down retail prices. Thus, the repeal of the LCM method would have an even greater adverse effect on businesses' tax liabilities in a down economy, at a time when businesses can least afford additional tax liabilities.

Overall, inventory accounting methods are essential to any tax system. And, to achieve the goal of simplicity, stability and predictability, such accounting methods should be simple to apply in order to ensure proper compliance and predictably enforced by the IRS to minimize disputes.

Investment in Workforce

Fundamental to every retail business is its workforce of sales associates, managers, and company executives, and for retail businesses to grow, whether by brick-and-mortar stores or online, requires a dedicated workforce to make the retail sales that ultimately contribute significantly to the overall economy. From that perspective, reducing the tax burden on American businesses holds significant potential for job creation by allowing retailers to invest tax savings in their workforce along with retail facilities.

Depending on the degree to which the tax rates are reduced, RILA urges the Committee to evaluate the continued benefits of providing employment incentives, such as the WOTC, which are intended to increase employment of individuals from specific targeted groups. Historically, the WOTC has helped offset the added costs of hiring and training individuals who rely on public assistance programs or are qualified veterans, disabled persons, low-income seniors, high-risk youth, or residents of designated areas. And, through these credits, businesses have helped disadvantaged individuals find meaningful employment in retail and other settings.

If the WOTC is retained as part of overall tax reform, which RILA would support, it should be made permanent, rather than perpetuating its current temporary status with periodic, and often retroactive, extension. Moreover, consideration should be given to simplifying the program to reduce the associated compliance costs. A permanent and simplified program would remove uncertainty in business planning, expand employer participation, and improve program administration.

Investments in Capital Assets

Along with its workforce, retailers must maintain an inviting, modern shopping environment to attract and maintain customer loyalty. Investment in new stores and facilities is an enormous financial undertaking that can be influence greatly by the tax treatment of that investment along with the treatment of repair and remodeling costs, which typically occur every five to seven years. Whether a large format retail operation or a smaller store, retailers spend significant resources on “build out” and other improvements to reflect changes in their customer base and to compete with newer stores.

As the cost recovery rules are considered, RILA urges the Committee to ensure that they reflect the true economic life of the property. It is well established that the current 39-year depreciation period for buildings often bears little relationship to the economic life of such structures and even less to building improvements and upgrades required in successful retail businesses. The current 15-year recovery period for retail and restaurant remodeling costs is a step toward such an economically reflective cost recovery, although the period still exceeds the true life of the improvements in many cases. In order to achieve an accurate reflection of the income derived in large measure through such property, RILA believes that retailers, whether they own or lease their stores, should depreciate such improvements over their economic useful lives, rather than based on an arbitrary and substantially longer recovery period set out in the tax code.

Similarly, RILA urges the Committee to examine rules governing the capitalization of expense relating to capital assets versus those permitting the deduction of expenses for maintenance and repairs. The complexity and ambiguities surrounding such rules lead to ongoing disputes with the IRS, with substantial amounts of time and money spent to resolve issues, in some cases year after year. Clear rules would free up resources, facilitate investment in new facilities as well as improvements to existing ones, and ultimately support overall business growth and job creation.

International Tax Reform

RILA applauds the Committee's efforts to examine the international implications of tax reform on the competitiveness of U.S. businesses operating in the global economy. A growing number of U.S. retailers have expanded into the global marketplace in recent years through the establishment of both retail operations in other countries as well as subsidiaries that strengthen the supply-chain of goods and services they provide to their customers. With the United States being one of the last countries to tax worldwide business income and soon to have the highest corporate tax rate, U.S. retailers operating and looking to expand abroad face significant competitive barriers. These obstacles not only constrain a retailer's ability to grow internationally, but also cost the United States the well-paying jobs that a company typically must add to oversee such global operations.

As the tax reform debate progresses, we urge the Committee to continue examining the international tax regime and consider moving the United States to some form of a territorial tax system. With the United Kingdom and Japan most recently embracing such a construct for the taxation of foreign subsidiaries of their domestic companies, the United States should not be left behind while putting U.S. multinationals at a further disadvantage to their global competitors. We appreciate that shifting to a territorial tax system raises a number of challenges such as the treatment of intangible property, transfer pricing rules, and business expense allocation rules. Nevertheless, we believe that the benefits that such a system could bring in terms of simplification, improved competitiveness, and reduction in economic distortions would far exceed any challenges.

Retailers compete every day for consumers' loyalty and spending. The nation's tax rules, domestic and international, should foster their success – not erect competitive barriers – especially as retailers continue to expand into the global marketplace.

Individual Tax Reform

While not directly affecting the business income tax system, the individual tax rules have a significant indirect impact on the retail industry. Individual tax rates and taxable income have a direct effect on consumer spending as well as on their ability to save and invest, which is an important source of capital for retail businesses. Accordingly, RILA applauds the Committee's recognition that tax reform should not be undertaken piecemeal, but rather comprehensively. And, RILA urges the Committee to give careful consideration to the effect that tax rates, as well as other components of the individual tax code like the alternative minimum tax, have on consumer spending, which contributes to the overall growth in the economy and businesses ability to increase capital for investment and job creation.

Conclusion

Thank you for this opportunity to present our views on tax reform. RILA and its members look forward to working with the Committee to enact meaningful tax reform that includes provisions that support the retail industry and help it to continue to create jobs and grow.

Sincerely,

Bill Hughes
Senior Vice President, Government Affairs

PRINCIPLES FOR TAX REFORM

- ***Keep tax rates low*** – Enabling individuals to keep more of what they earn encourages savings and enables them to make purchases of needed consumer products, which also has the benefit of providing a major stimulus to the economy including sustained, improved retail sales. Similarly, low tax rates help American businesses by increasing capital for investment and job creation.
- ***Enact simple, predictable and easy to understand tax rules*** – A tax system that individual and business taxpayers can easily understand will improve compliance and reduce the cost of tax administration.
- ***Establish tax rules that are consistent with economic reality*** – For business taxpayers in particular, tax rules need to result in appropriate timing and accurate reflection of income without arbitrary rules that, for example, delay deductions beyond the period in which the income is earned or set depreciation periods inconsistently with the real economic life of the property.
- ***Ensure the tax system fosters business competitiveness and promotes economic growth*** – In an increasingly global economy, the tax system should not hinder the ability of U.S. businesses to compete internationally as well as domestically against foreign firms. A tax code that treats business fairly and equitably will minimize burdens on compliance and decision-making, thereby enhancing the productive capacity of U.S. businesses and the U.S. economy.
- ***Implement reforms that ensure industry-specific neutrality*** – Business decisions should be based on economic benefits of the particular transaction, not driven by special tax benefits targeted to one industry versus another. The economy does not benefit when the tax code chooses winners and losers. Accordingly, tax reform should allow the marketplace, not the tax system, to allocate capital and resources appropriately.
- ***Avoid a whole-scale change in the tax base*** – Dramatic shifts in tax policy, such as implementing a national retail sales or value-added tax, would be immensely disruptive to the economy and particularly detrimental to lower-income workers and families.
- ***Make changes permanent and ensure certainty*** – A new tax system must be permanent and stable, not littered with expiring provisions that cause uncertainty for families saving for college and retirement and business striving to expand, create jobs, and remain competitive in the United States and abroad.
- ***Provide realistic transitions rules*** – Significant changes to the current tax system will create substantial burdens on taxpayers, especially in the business sector, to ensure compliance. Establishing transition rules that provide adequate time for implementation and that take into account existing agreements, practices, and other requirements is essential for the success of any new tax system.
- ***Recognize that tax revenues are one part of fiscal discipline*** – As with any business, long-term fiscal viability requires careful management of *both* revenues and expenses. The tax-revenue lever can only be pulled so much and so often before it harms the business sector (with resulting effects on tax revenues from businesses, employees, and investments). Equal attention must be given to government spending to strike a reasonable balance with a tax code that fosters economic growth, job creation, and investment.